

Message Text

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ACTION NEA-12

INFO OCT-01 EA-11 ADP-00 INT-08 SCEM-02 L-03 H-02 AID-20

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FM AMEMBASSY NEW DELHI

TO SECSTATE WASHDC 5456

INFO AMEMBASSY COLOMBO

AMEMBASSY DACCA

AMEMBASSY ISLAMABAD

AMEMBASSY RANGOON

AMCONSUL BOMBAY

AMCONSUL CALCUTTA

AMCONSUL MADRAS

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E.O. 11652: N/A

TAGS: ENRG, IN

SUBJ: LATEST ADDITIVE TO OLD GOI OIL POLICY MAY HASTEN FOREIGN

COMPANY DEMISE IN INDIA

REF: (A) NEW DELHI 7536; (B) NEW DELHI 3963; (C) NEW DELHI 3992;
(D) NEW DELHI 4879

BEGIN SUMMARY: INDIA APPEARS TO BE GRADUALLY, BUT RESOLUTELY
CHANGING ITS OIL POLICY. OUT OF NECESSITY, THE GOI HAS ACCEPTED
THE CURRENTLY IRREVERSIBLE WORLD MARKET CRUDE OIL PRICING TREND,
AND IS ATTEMPTING TO ADJUST ACCORDINGLY WITHIN THE FRAMEWORK OF ITS
SOCIALIST-ORIENTED INDUSTRIAL POLICY. THE GOVERNMENT'S ADJUSTMENTS
INTENSIFY ITS PROGRAM TO GAIN CONTROL OF ALL ASPECTS OF THE
PETROLEUM REFINING AND DISTRIBUTION PROCESS IN INDIA; AND A NEW
TWIST HAS BEEN ADDED. THE RESULT COULD HASTEN THE DEPARTURE
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FROM INDIA OF BURMAH-SHELL, CALTEX AND ESSO, WHILE BELATEDLY

OPENING THE DOORS TO FOREIGN OIL EXPLORATION FIRMS. THE CURRENT POSITION AND OUTLOOK OF EACH OF THE THREE FOREIGN PRIVATE OIL REFINING COMPANIES OPERATING IN INDIA IS DESCRIBED BRIEFLY HEREIN. IT WILL BE FURTHER ANALYZED IN DEPTH IN AN AIRGRAM TO FOLLOW. END SUMMARY.

1. PROLONGED AND SEVERE CRITICISM IN PARLIAMENT AND THE PRESS AGAINST THE GOI'S "SHORT-SIGHTED PETROLEUM POLICY", COUNTRYWIDE PETROLEUM PRODUCT SHORTAGES, AND GROWING CONCERN OVER THE RISING FOREIGN EXCHANGE DRAIN FROM CRUDE OIL IMPORTS HAVE COMBINED TO TRIGGER THE GOVERNMENT INTO UNPRECEDENTED ACTIONS IN OIL MATTERS.

WHEREAS IN THE PAST THE GOI SEEMED CONTENT TO LIVE SOLELY WITHIN THE NARROW CONFINES OF ITS 20-YEAR-OLD POLICY, NEW INTERPRETATIONS ARE NOW BEING ADDED, AND PLANS ARE EMERGING THAT MAY WELL HAVE AN EARLY IMPACT ON THE INDUSTRY AND THE CONSUMER.

2. THE GOI IS ACCELERATING ITS EFFORT ULTIMATELY TO TAKE OVER ALL PRIVATE SECTOR REFINING AND MARKETING ORGANIZATIONS OPERATING IN INDIA. THE GOVERNMENT IS CONTINUING THE ON-GOING EQUITY SHARE OFFER

MADE BY ESSO (REF A), AND IS ACTIVELY NEGOTIATING TO REDUCE BURMAH OIL COMPANY'S HALF INTEREST IN OIL INDIA LIMITED, PRESUMABLY AS A PRELUDE TO GOI/BURMAH-SHELL EQUITY SHARE NEGOTIATIONS LATER. MEANWHILE, WHILE BY ACCIDENT OR DESIGN, CALTEX, THE SMALLEST OF THE THREE FOREIGN COMPANIES, IS CAUGHT IN A SQUEEZE PLAY. THIS COULD DENUDE CALTEX OF ITS RUPEE ASSETS WHILE THE COMPANY WAITS FOR THE GOI TO DEAL WITH IT AS IT WISHES IN THE NORMAL COURSE OF THE GOVERNMENT'S OVERALL TAKEOVER PLAN.

3. IN APRIL, IN A DRAMATIC AND COSTLY POLICY REVERSAL, THE GOVERNMENT INFORMED BURMAH-SHELL, CALTEX AND ESSO THAT ALL RESTRICTIONS WOULD BE REMOVED ON FOREIGN EXCHANGE ALLOTMENTS FOR THE PURCHASE OF IMPORTED CRUDE OIL (REF B). THAT IS, EACH COMPANY WOULD BE ALLOWED ALL THE FOREIGN EXCHANGE IT REQUIRED TO PROCURE ENOUGH CRUDE TO OPERATE ITS REFINERY AT ITS FULLY INSTALLED CAPACITY. ON JUNE 11, AFTER TWO YEARS OF DELIBERATIONS, THE GOI MODIFIED UPWARD ITS BASIC CEILING SELLING PRICES OF ALL MAJOR PRODUCTS (EXCEPT LIMITED OFFICIAL USE

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KEROSENE). THE NEW PRODUCT PRICING STRUCTURE IS PEGGED TO A NON-EXISTENT CRUDE OIL PRICE OF \$1.88 PER BARREL. AT FIRST GLANCE THIS MAY SEEM LIKE A REASONABLE COMPROMISE WHICH LIMITS THE PRICE INCREASE TO THE CONSUMER, OBTAIN FULLER UTILIZATION OF CAPACITY,

AND IMPROVE THE CASH POSITION OF THE LOCAL REFINING AND MARKETING COMPANIES. THE COMPROMISE, HOWEVER, IS PAINFUL FOR THE LOCAL SUBSIDIARIES OF THE OIL COMPANIES, SINCE THE

PRICE RISES FOR PRODUCTS DO NOT FULLY COVER HIGHER CRUDE COSTS.

4. AT THE TIME THE NEW PRODUCT PRICING STRUCTURE WAS ANNOUNCED, THE ACTUAL PRICE OF AGHAJARI CRUDE (FOR EXAMPLE) WAS \$2.35 PER BARREL (FOB PERSIAN GULF), AND ON JULY 1 THE PRICE INCREASED XUFTHER TO \$2.55 PER BARREL. THE GOI'S FORMULA CUSHIONS INDIAN CONSUMERS FROM INCREASED PRICES OF CRUDE OIL ON THE WORLD MARKET, AND IT ALSO PERMITS EACH PRIVATE COMPANY A FULL DOLLAR RETURN TO ITS OWN CRUDE SUPPLIERS OUTSIDE INDIA. HOWEVER, THE REFINING COMPANIES IN INDIA MUST PURCHASE THEIR DOLLARS FOR CRUDE IMPORTS WITH RUPEES EARNED FROM THE SALE OF PRODUCTS. RUPEE RETURNS BASED ON A HYPOTHETICAL CRUDE PRICE OF \$1.88 PER BARREL WILL NOT BUY \$2.55 WORTH OF CRUDE OIL. THE COMPANIES THEREFORE HAVE THREE OPTIONS: (1) THEY MAY VOLUNTARILY REFUSE TO ACCEPT MORE DOLLARS THAN THEIR RUPEE INCOMES WOULD PERMIT (AND THUS BE EXPOSED TO PUBLIC CRITICISM FOR NOT ASSISTING THE COUNTRY IN A "TIME OF NEED"); (2) THEY MAY OPERATE ON A RUPEE-LOSS BASIS TO GAIN DOLLAR INCOMES THROUGH CRUDE PURCHASES FROM THEIR OWN SOURCES (WHICH, IN TURN, WILL PRESUMABLY ULTIMATELY REDUCE EACH COMPANY'S RUPEE HOLDINGS TO ZERO); OR (3) THEY MAY USE DOLLARS EARNED OUTSIDE INDIA TO BUY RUPEES TO COVER DEFICITS IN INDIA CAUSED BY AN IMBALANCED IN-COUNTRY PRICING FORMULA.

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INFO OCT-01 EA-11 ADP-00 INT-08 SCEM-02 L-03 H-02 AID-20

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TO SECSTATE WASHDC 5457

INFO AMEMBASSY COLOMBO

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5. OPTION (2) HAS BEEN AT LEAST TEMPORARILY ADOPTED BY EACH FIRM, ALTHOUGH THE THREE OIL COMPANIES APPEAR TO BE RESPONDING DIFFERENTLY TO THE PROFIT SQUEEZE. BURMAH-SHELL AND ESSO SEEM WILLING TO ACCEPT THE SITUATION. EACH MAY HOPE TO ENHANCE ITS BARGAINING POSITION WITH THE GOI BY WAY OF A DEMONSTRATED COOPERATIVE EFFORT AND/OR EACH MAY ALSO CURRENTLY PREFER TO DRAW DOWN ITS RUPEE HOLDINGS IN LIGHT OF THE PROBABLE TERMINATION OF ON-GOING REFINERY AGREEMENTS ON OR BEFORE 1980. CALTEX, ON THE OTHER HAND, INSISTS THAT IT IS GOING BANKRUPT AND THAT IT IS VALNERABLE TO AN EARLY GOI ACQUISITION OF ITS ASSETS BY ATTRITION. ALTHOUGH IN THE PAST CALTEX HAS CLAIMED IT WAS LOSING MONEY WHEN IN FACT IT WAS NOT, ITS CURRENT POSITION MAY WELL BE TENUOUS.

6 THE GOI HAS CLAIMED FOR SOME YEARS THAT THE FOREIGN PRIVATE OIL COMPANIES HAVE MADE "EXCESSIVE PROFITS" IN INDIA.
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CLEARLY, THE GOVERNMENT INTENDS TO ACT ON ITS BELIEF FOR THE FIRST TIME. IF THE PRESENT PROFIT SQUEEZE PROVES TO BE TOO SEVERE, THE GOI COULD ONCE AGAIN REVISE ITS CEILING SELLING PRICES UPWARD. CONVERSELY, IF BURMAH-SHELL AND ESSO REMAIN SILENT NOW, THE GOI WILL SIMPLY RETRIEVE RUPEES IT CLAIMS IT DESERVES. THE GOI MAY CONSIDER IT CAN AFFORD TO SACRIFICE CALTEX.

7. MEANWHILE, THERE SEEMS TO BE LITTLE OR NO RELIEF IN SIGHT FOR THE GOI IN MATTERS RELATED TO THE RISING COSTS OF IMPORTED CRUDE OIL. STRENUOUS EFFORTS ARE UNDER WAY TO OBTAIN ASSURED ALTERNATE SOURCES, WITH SOME SUCCESSES IN IRAN, SAUDI ARABIA AND IRAQ. HOWEVER, PRICES TO INDIA FROM EACH OF THESE SOURCES ARE NOT CONCESSIONARY. ON THE DOMESTIC FRONT, INDIA IS ON THE THRESHOLD OF ITS FIRST ATTEMPT TO EXPLORE ITS DEEP WATER OFFSHORE BOMBAY HIGH GEOLOGIC STRUCTURE (REF C), AND HAS ALSO TURNED TO FOREIGN CONTRACTORS TO ASSIST THE GOVERNMENT IN ITS ALMOST DESPERATE ATTEMPT TO TAP POSSIBLE RESERVES ELSEWHERE IN ITS CONTINENTAL SHELF (REF D).

8. TIME DOES NOT FAVOR INDIA IN OIL. WHILE IT MAY BE ARGUED THAT THE GOI SHOULD HAVE UNDERTAKEN AT LEAST SOME PORTION OF ITS PROGRAM TO ATTAIN SELF-SUFFICIENCY IN PETROLEUM A DECADE AGO, THE FACT REMAINS THAT THE GOVERNMENT MUST NOW ACCOMPLISH MUCH IN A SHORT PERIOD OF TIME IF ITS DIFFICULT GOAL OF SAVING FOREIGN

EXCHANGE

BY REDUCING OIL IMPORTS IS TO BE MET. ALL MAJOR EFFORTS IMPORTANT TO THE GOVERNMENT -- TAKEOVER OF THE PRIVATE REFINING COMPANIES, THE PURCHASE OF ALTERNATE SUPPLIES OF CRUDE FOR IMPORT, AND EXPLORATION IN INDIA -- CONTINUE TO FOCUS ON 1980. OVERDUE AND INCORRECTLY ORIENTED THOUGH THEY MAY WELL BE, THE INITIAL MOVES HAVE BEEN MADE. OTHER WILL FOLLOW. THE GOVERNMENT'S CURRENTLY-CHANGING OIL POLICY IS FINALLY, AND CLEARLY, IN THE OPEN. IT CAN BE, AND MUST BE, WATCHED CAREFULLY IF LEGITIMATE AMERICAN COMPANY INTERESTS ARE TO BE PROPERLY PROTECTED.

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